

ORDER NO. 16 4 23

ENTERED NOV 08 2016

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

UF 4298

In the Matter of

ROATS WATER SYSTEM, INC.,

Application to Issue Stock, Bonds, Notes, or  
Other Securities.

ORDER

**DISPOSITION: STAFF'S RECOMMENDATION ADOPTED**

At its public meeting on November 8, 2016, the Public Utility Commission of Oregon adopted Staff's recommendation in this matter. The Staff Report with the recommendation is attached as Appendix A.

BY THE COMMISSION:



  
**Kristi Collins**  
Commission Secretary

A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Circuit Court for Marion County in compliance with ORS 183.484.

PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: NOVEMBER 8, 2016

REGULAR \_\_\_\_\_ CONSENT X EFFECTIVE DATE \_\_\_\_\_ Upon Approval \_\_\_\_\_

DATE: October 25, 2016

TO: Public Utility Commission

FROM: Joan Grindeland

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck

SUBJECT: ROATS WATER SYSTEM, INC.: (Docket No. UF 4298) Application to encumber utility property.

**STAFF RECOMMENDATION:**

Staff recommends that the Public Utility Commission of Oregon (PUC or Commission) approve Roats Water System, Inc.'s (Roats or Company) request to borrow the sum of \$1,400,000 from the City of Bend, subject to the following conditions and reporting requirements:

1. Roats agrees to provide the Commission with access to all books of account as well as all documents, data, and records that pertain to the Juniper Utility system purchase.
2. Roats agrees that it will provide a report indicating the final terms of the loan within 30 days of closing. Roats further agrees to notify the Commission of any substantive changes to the loan terms, including any material change in the loan amount or interest rate. In the event Staff finds that any such change may in fact be material, Staff will notify the Company and the Company agrees to promptly file an application requesting a supplemental order (or other appropriate order) be issued approving the new loan terms and conditions.
3. Roats agrees to file the appropriate application with the Commission, pursuant to ORS 757.480(5), prior to disposing of its right to provide service to The Pines and Crown Villa pursuant to paragraph 1.3 of the Asset Purchase Agreement. Roats agrees that it will not cease providing service to The Pines and Crown Villa absent approval by the Commission, or as a result of condemnation proceedings.
4. Roats agrees that it will not seek compensation from its customers related to the \$1,000 per acre charge that it may incur pursuant to paragraph 3.7 of the Asset Purchase Agreement if Roats sells any of its Arnold Irrigation water rights to a party other than Avion or a successor in interest.

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5. The Commission reserves judgment on the reasonableness for ratemaking purposes of the Company's financing costs. In its next rate proceeding, Roats will be required to show that its capital costs, including embedded expenses and capital structure, are just and reasonable. The Commission reserves the right to review, for reasonableness, all aspects of this transaction in any rate proceeding or alternate form of regulation.
6. Loan proceeds shall only be used for the purposes set forth in the Asset Purchase Agreement, and according to the terms set forth in the promissory note.

#### DISCUSSION:

##### Background:

Roats is a private water utility regulated by the PUC that provides water to 1,485 residential and 180 commercial customers in the area south of Bend, Oregon.<sup>1</sup> On June 21, 2016, Roats filed its Application to Issue Stock, Bonds, Notes or Other Securities (Application) with the Commission pursuant to ORS 757.415(2) and OAR 860-036-0720. The purpose of the Application is to gain approval for the Company to borrow \$1,400,000 from the City of Bend, with 6.5 percent interest per year, for the purchase of the Juniper Utility system from the City of Bend pursuant to the Asset Purchase Agreement signed by the City of Bend on August 9, 2016.<sup>2</sup>

The City of Bend initiated condemnation proceeding in 2002 to acquire the Juniper Utility system following a protracted effort to get the utility to provide safe and adequate service to its customers at just and reasonable rates.

The City of Bend signed a settlement agreement with four Homeowners' Associations (HOAs) served by the legacy Juniper Utility system to replace the existing two pipe system with the City's standard one pipe system, which would effectively eliminate irrigation services. In 2013, the HOA's expressed concerns to the Bend City Council regarding the costs to convert the Juniper Utility system to the one pipe City system. At that time, the City contacted Roats and Avion Water Company (Avion) to see if they were interested in purchasing the system from the City.

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<sup>1</sup> The Company's Application listed its residential customer count at 1,485 and its commercial customer count at 180. The Company subsequently asserted that its residential customers total 1,562 and commercial 187.

<sup>2</sup> At the time that this public meeting memo was finalized, Staff was not aware of any opposition to this Application; however, there has been general interest and participation by customer-intervenors in the Company's currently pending general rate case (Docket UW 166).

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Over the last ten years, the City spent millions of dollars on repairs and replaced major elements of the Juniper Utility system. Those repairs made the operation and maintenance of the system affordable. After more than a decade of negotiations and discussion with the four HOAs, it is clear they value having separate non-potable irrigation systems and this sale satisfies their concerns.

In April 2016, in response to requests from the HOAs and individual property owners, the City decided to divest itself of the Juniper Utility system and to sell certain assets (including real property, easements and water rights) to Roats and Avion.

On August 9, 2016, Roats and the City signed an Asset Purchase Agreement, contingent on Commission approval,<sup>3</sup> where the City will be paid the sum \$1,400,000.00. Under the terms of the Asset Purchase Agreement, Roats is seeking to purchase the portion of the City's water system that serves Tillicum Village, Timber Ridge, Mountain High, Blue Ridge, The Pines, and Crown Villa, together with the Hole 10 real property and the Arnold Irrigation water rights held by the City (hereinafter, Assets). Terms of the loan are as follows:

1. No down payment shall be made at closing.
2. The interest rate will be 6.5 percent per year.
3. Payments for the first three years will be interest only, with the first payment due one year from the date of this Note. Beginning at year four, the balance will be amortized over 20 years.
4. The entire unpaid balance, both principal and interest, shall be due 20 years from the date of this Note. Payments will be made annually based upon the date of the Note.
5. Equal debt service payments will be made annually during years 4 through 19, with the unpaid balance due at the end of the 20 year term.
6. There is no prepayment penalty.

Issue:

Whether the Commission should issue an order authorizing Roats to finance its acquisition of the Assets from the City of Bend pursuant to the Asset Purchase Agreement.

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<sup>3</sup> Staff notes that this filing is procedurally unique in that the Commission is not required to approve the sale of the Juniper Utility system pursuant to ORS 757.480, nor Roats' purchase of the Juniper Utility system pursuant to ORS 759.485, because the Assets are owned by a municipality not subject to the Commission's jurisdiction.

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Applicable Law:

ORS 757.415(1)(a) requires a public utility to obtain an order from the Commission prior to taking on debt for the acquisition of property.<sup>4</sup> ORS 757.415(1) sets forth the purposes for which securities or notes may be issued. ORS 757.415(2) sets forth the legal standard and requirements that must be addressed in the Commission's order:

- (2) Before issuing such securities, a public utility, in addition to the other requirements of law, shall secure from the commission upon application an order authorizing such issue, stating:
  - (a) The amount of the issue and the purposes to which the issue or the proceeds thereof are to be applied;
  - (b) In the opinion of the commission, the money, property or labor to be procured or paid for by such issue reasonably is required for the purposes specified in the order and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility, and will not impair its ability to perform that service; and
  - (c) Except as otherwise permitted in the order in the case of bonds, notes or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

OAR 860-036-0720 sets forth the information that must be included in a water utility's financing application.

Discussion and Analysis:

Roats states that it will use the proceeds of the securities or notes for the acquisition of the Juniper Utility System. This is consistent with ORS 757.415(1)(a).

Roats asserts that there are several benefits to its current customers. Roats' current customers will enjoy lower rates due to economies of scale as Roats will have a bigger customer base to spread its costs over. Roats customers will also realize operational benefits because the acquisition of Juniper allows Roats the ability to supply all customers with a gravity supply system with more than adequate storage through large distributions mains acquired with the purchase of the Juniper System. This adds more redundancy and fire flow to the current system, as well as providing continued service during repairs, emergencies and power outages.

Roats also asserts that it has the ability, experience, financial planning, and future infrastructure master planning capacity to effectively operate the assets serving the new service territory and is acquiring the territory with the long-term intent to provide service.

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<sup>4</sup> ORS 757.417 limits the application of ORS 757.415 in certain circumstances not applicable to this case.

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To determine whether the purchase of Juniper is compatible with the public interest, Staff performed a 20 year net present value analysis of the impacts of the proposed purchase on Roats' existing customers. Staff estimated the benefits that will result from the purchase through a comparison of the per customer costs with and without the purchase. These savings primarily result from spreading costs over a larger customer base (i.e., economies of scale). Because Roats' existing customers will not have access to the non-potable irrigation available to Juniper customers, neither the costs nor of the benefits that irrigation system are included in the analyses.

Staff's analysis includes a number of sensitivities regarding cost items including: A) capital costs, B) inflation rates, and C) discount rates. Each of those sensitivities is addressed below, and referenced to the applicable scenario on the NPV Comparison -- Attachment A. Staff's base case, the components of which are described below, is Scenario 1 in Attachment A.

*Sensitivities:*

A. Capital costs

Staff included the impact of the potential additional costs associated with the Juniper purchase. Roats estimated \$2.7 million to replace the entire 36,000 feet of Juniper infrastructure. Staff's scenarios assume replacement of the entire infrastructure over both 15 (Scenario 1) and 20 (Scenario 2) years. Staff believes that the infrastructure will, in fact, be replaced only on an as needed basis.

Staff's analysis also includes the impact of significant capital additions Roats expects to make over the next 20 years to its existing infrastructure, including a reservoir replacement and pipe replacements expected through the study period totaling \$500,000. To the extent a portion of these expenditures are borne by former Juniper customers, current Roats' customers enjoy the benefit.

B. Inflation Rates

Staff's analysis looked at the following three inflation rates:

1. Low – 0 percent (Scenario 3)
2. Base case – 2 percent. Staff chose 2 percent as its base case as it is consistent with recent history and the Federal Open Market Committee's (FOMC) stated inflation goal. (Scenario 1)
3. High – 10 percent (Scenario 4)

C. Discount Rates

Staff's analysis looked at the following three discount rates:

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1. Low – 1.75 percent represents approximately the current rate on a 10 year US treasury bond (Scenario 5)
2. Base case – 7.89 percent the rate of return incorporated in the filing (Scenario 1)
3. High – 10 percent (Scenario 6)

Unlike Juniper customers who have access to non-potable water for irrigation, Roats' current customers use potable domestic water to irrigate. As a result, Roats' customers' usage per customer of domestic potable water is higher than Juniper customers' usage. In recognition of this difference, Staff also performed an analysis based on actual consumption, rather than on cost per customer. (Scenario 7)

Due to the drought conditions experienced over the last several years, Staff performed an analysis on the impacts on Roats' current customers of irrigation water not being available from Arnold Irrigation (i.e., no service to customers of the non-potable irrigation system). This analysis reflects the fixed costs associated with that irrigation system being borne by Roats' current customers. (Scenario 8)

The benefits to current Roats' customers totaled \$2,297,670 in the base case scenario. Results from all scenarios show benefits ranging from \$1,095,899 to \$4,892,975. In each case, the acquisition of Juniper results in benefits to Roats' current customers. Staff's analysis demonstrates that Roats' request for Commission approval of financing the Juniper Utility system acquisition from the City of Bend is compatible with the public interest, is consistent with Roats' provision of service as a public utility, and will not impair Roats' ability to perform its service obligations. Moreover, Staff's analysis demonstrates that Roats' current customers will benefit from the acquisition over the long term.

Conclusion:

Based on the review of this Application, and information provided by Roats, Staff concludes the Application will do no harm and can be expected to benefit Roats' current customers.

**PROPOSED COMMISSION MOTION:**

Approve Roats Water System's application for the authority to borrow \$1,400,000 from the City of Bend for the purchase of the Juniper Utility system with Staff's conditions and reporting requirements.

roatsuf4298

NPV Comparison								
Base Case								
Scenarios	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Inflation Rate	2%	2%	0%	10%	2%	2%	2%	2%
Capital Addition (yr)	15	20	15	15	15	15	15	15
Discount Rate	7.89%	7.89%	7.89%	7.89%	1.75%	10.00%	7.89%	7.89%
Year	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>	Benefit / <cost>
2017	\$ 277,573	\$ 279,708	\$ 277,573	\$ 277,573	\$ 285,828	\$ 274,900	\$ 190,143	\$ 209,222
2018	\$ 253,822	\$ 259,765	\$ 248,677	\$ 274,404	\$ 277,147	\$ 246,560	\$ 168,665	\$ 189,204
2019	\$ 232,498	\$ 241,690	\$ 223,155	\$ 271,775	\$ 269,186	\$ 221,517	\$ 149,638	\$ 171,408
2020	\$ 207,230	\$ 219,176	\$ 194,512	\$ 263,510	\$ 254,413	\$ 193,658	\$ 127,939	\$ 149,476
2021	\$ 177,574	\$ 191,830	\$ 162,191	\$ 249,337	\$ 231,164	\$ 162,764	\$ 101,160	\$ 122,974
2022	\$ 157,427	\$ 173,600	\$ 140,117	\$ 242,801	\$ 217,306	\$ 141,531	\$ 84,401	\$ 105,808
2023	\$ 139,306	\$ 157,049	\$ 120,576	\$ 237,091	\$ 203,900	\$ 122,840	\$ 69,558	\$ 90,506
2024	\$ 123,022	\$ 142,026	\$ 103,305	\$ 232,146	\$ 190,934	\$ 106,401	\$ 56,440	\$ 76,887
2025	\$ 108,089	\$ 128,083	\$ 87,751	\$ 227,597	\$ 177,883	\$ 91,693	\$ 44,626	\$ 64,473
2026	\$ 94,422	\$ 115,166	\$ 73,772	\$ 223,466	\$ 164,770	\$ 78,564	\$ 34,017	\$ 53,187
2027	\$ 82,209	\$ 103,494	\$ 61,504	\$ 220,036	\$ 152,118	\$ 67,092	\$ 24,734	\$ 43,227
2028	\$ 71,310	\$ 92,952	\$ 50,764	\$ 217,252	\$ 139,915	\$ 57,081	\$ 16,638	\$ 34,456
2029	\$ 61,595	\$ 83,434	\$ 41,383	\$ 215,065	\$ 128,149	\$ 48,360	\$ 9,605	\$ 26,754
2030	\$ 52,948	\$ 74,845	\$ 33,212	\$ 213,429	\$ 116,808	\$ 40,774	\$ 3,523	\$ 20,010
2031	\$ 45,264	\$ 67,099	\$ 26,115	\$ 212,302	\$ 105,882	\$ 34,188	\$ (1,711)	\$ 14,123
2032	\$ 42,124	\$ 60,116	\$ 22,706	\$ 223,063	\$ 104,485	\$ 31,207	\$ (2,266)	\$ 12,684
2033	\$ 42,644	\$ 53,824	\$ 22,232	\$ 244,050	\$ 112,160	\$ 30,987	\$ 924	\$ 14,812
2034	\$ 42,904	\$ 48,158	\$ 21,706	\$ 263,986	\$ 119,655	\$ 30,578	\$ 3,688	\$ 16,592
2035	\$ 42,937	\$ 43,059	\$ 21,138	\$ 282,976	\$ 126,974	\$ 30,015	\$ 6,070	\$ 18,061
2036	\$ 42,772	\$ 38,472	\$ 20,537	\$ 301,115	\$ 134,121	\$ 29,327	\$ 8,108	\$ 19,255
Total Savings	\$2,297,670	\$2,573,547	\$1,952,927	\$4,892,975	\$3,512,798	\$2,040,037	\$1,095,899	\$1,453,117